



DEPARTMENT OF THE TREASURY OFFICE OF PUBLIC AFFAIRS

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Contact Tony Fratto
at 202-622-2960.

TREASURY UNDER SECRETARY JOHN B. TAYLOR TESTIMONY BEFORE THE SUBCOMMITTEE ON INTERNATIONAL MONETARY POLICY AND TRADE OF THE HOUSE COMMITTEE ON FINANCIAL SERVICES

Chairman Bereuter, Ranking Member Sanders, Members of the Subcommittee, thank you for the opportunity to testify today on the achievements made to date on the Administration's Multilateral Development Bank (MDB) reform agenda and our specific authorization requests.

Reform of the MDBs has been one of the highest priorities of the Bush Administration's international economic agenda. The MDBs are important instruments in helping to raise economic growth and prosperity around the world. But the effectiveness of the institutions in making a difference in the lives of the poor can be substantially improved. The MDBs can and must do a better job. From the start of the Administration, three hallmark reforms have been pursued – a greater focus by the institutions on increasing productivity growth; an insistence on measurable results; and an increased proportion of assistance to the poorest countries delivered in the form of grants rather than loans.

Steady progress has been made on all these fronts since the start of the Administration, and this progress provides the grounds for today's request for authorization to replenish the International Development Association (IDA-13) and the African Development Fund (AfDF-9). An authorization request is pending for the replenishment of the Asian Development Fund (AsDF-8) and negotiations are still underway for replenishment of the Global Environment Facility (GEF-3), for which authorization is provided by prior legislation. The Administration is also seeking authorization to implement certain reforms of the North American Development Bank (NADBank), along the lines agreed by Presidents Bush and Fox.

President Bush's appropriations request for the MDBs in FY03 totals \$1.437 billion. In the case of the increment for IDA, the authorization request is an 18% increase over prior replenishment requests. Importantly, the requested increase entails a new focus on measuring and achieving results from IDA funding. In fact, for the first time ever, part of the replenishment is contingent

on achieving real results on the ground. Absent achievement of progress towards stated objectives, the Administration will not seek appropriations for that additional funding.

IDA-13: Reforms to Raise Economic Growth in Poor Countries

Negotiations for the thirteenth replenishment of IDA concluded earlier this month. This replenishment will enable the organization to provide a total of \$23 billion in loans and grants to the poorest countries over the next three years. The Administration is requesting authorization to contribute up to \$2.850 billion over the next three years. The FY03 appropriations request consists of \$850 million for the first payment under IDA-13 and \$24 million to clear one-third of U.S. arrears.

As part of the IDA replenishment, the United States achieved three sweeping reforms fully reflective of the Bush Administration's MDB reform priorities:

- A significant increase in grant funding for the poorest countries;
- A contribution scheme that allows shareholders to link the contribution of additional resources to the achievement of results; and
- A greater focus of IDA resources on key productivity-driving activities, including private sector development.

First, the IDA replenishment achieves the President's vision of last summer "that up to 50 percent of the funds provided by the development banks to the poorest countries be provided as grants for education, health, nutrition, water supply, sanitation and other human needs." In fact, this landmark agreement means that IDA will provide nearly 100% of its assistance on grant terms for education, health, nutrition, potable water and sanitation in countries whose people live on less than a dollar a day. All of IDA's assistance for HIV/AIDS will be in grant form for all IDA-only countries, and up to 25% of such assistance to blend countries (those eligible for both IBRD and IDA) will also be in the form of grants. All of IDA's assistance for natural disaster reconstruction will be in grant form. And up to 40% of IDA's assistance to post-conflict countries will now be delivered on grant terms.

This is a significant achievement in terms of meeting the Administration's policy objective of helping poor countries make productive investments without saddling them with ever-larger debt burdens. Equally important, this approach will make a real difference in meeting the basic needs of poor people around the globe without significant costs to IDA.

While an increase in the amount of grants will mean a reduction in IDA repayments over the next 40 years, it is important to note that for the recipient countries, these additional saved "costs" – which are better referred to as "foregone debt repayments" – provide real and material benefits. Even in terms of foregone repayments, the amounts are modest and spread out over an extended period of time. Given the grace period attached to regular IDA funding, there is

virtually no reduction in the amount of IDA resources available to support borrowing countries over the first ten years.

It will not take much to offset these foregone repayments even after the first ten years. In their recent study on IDA grants, the U.S. General Accounting Office (GAO) produced an excellent analysis, which was very helpful. I referred to it many times as a way to explain the financial impact of the grants proposal to other donors. It estimated that donors would have to increase their contributions at an annual rate less than the rate of inflation to offset the costs of grants – that is a decline in real terms.

Second, another key achievement in the IDA replenishment is a contribution structure that allows donors to increase their levels of funding if concrete measurable results are achieved. Donors and developing countries will benefit from routinely quantifying development achievements and understanding the reasons for success and failure. This will increase learning and accountability for development results.

Donors agreed to measure progress towards two sets of results. The first set is needed to get the new measurable results system started. It requires that this system be established and that other analytical underpinnings of IDA's work be expanded. Timely and high quality diagnostic analyses, such as public expenditure reviews, financial accountability assessments, and investment climate assessments, are important tools for identifying the strengths and weaknesses in a country's ability to make the most effective use of IDA resources. The U.S. will provide an additional \$100 million if IDA makes concrete progress in this area.

The second set of results is in the areas of education, health, and private sector development. After careful consideration of both measurability (do the data exist in most IDA countries?) and relevance (do they reflect IDA's productivity growth and poverty reduction mandate?), progress will be tracked toward the following results:

- *Education:* Increase in aggregate primary school completion rates across IDA countries as well as an increase in the number of countries that have raised their completion rates.
- *Health:* Increase in measles immunization coverage across IDA countries as well as an increase in the number of countries with 80 percent coverage.
- *Private Sector Development:* Reductions in both the number of days and the official costs required to start businesses in IDA countries.

Reflective of the importance of human capital investment and vibrant private sectors to increasing productivity, the U.S. will provide an additional \$200 million if satisfactory results are achieved in the above areas.

It is important to keep in mind that this is just the start of a fundamental shift of focus in the MDBs to measurable results. A new measurement system must be created to implement the results approach; it will begin with a small but important set of indicators. And it will evolve

over time as the quality of data and evaluation systems in recipient countries are strengthened and as the MDBs, other shareholders, and developing countries realize that the U.S. priority on measuring results reflects a genuine desire to ensure that the lessons – both successes and failures – of 50 years of development assistance result in more effective assistance and less poverty around the world.

More broadly, pursuing a results-based approach in IDA and the other MDBs will require real changes in operating style. It means stating in quantitative terms the expected results of individual projects and overall country assistance before providing funding. It means measuring progress towards stated results and assessing the reasons for success and failure. It means structuring projects in a way that steps up or cuts back funding contingent on achieving results.

Third, IDA will devote significant resources over the next three years to projects and programs that raise productivity. The logic behind this approach rests in the simple fact that countries are poor because productivity is low. This requires concentrating IDA funding on addressing the basic causes of low productivity such as inadequate education, low business investment, and inadequate health care. For the first time, IDA funds can be used in the private sector, including increased collaboration with the International Finance Corporation (IFC), the arm of the World Bank Group that provides financial products to private sector projects in developing countries.

African Development Fund

Negotiations for the ninth replenishment of the African Development Fund (AfDF-9) are not yet complete. With strong U.S. leadership, the AfDF negotiators have already agreed on an important set of policy reforms including an enhanced focus on measurable results, an improved link between financial support and results, and deepened coordination with the World Bank and bilateral donors. The AfDF has a good record of providing information, and Management has committed to improving disclosure policies. The institution is also developing specific expertise in the areas of regional integration and governance, and will be adopting a new private sector strategy this year.

Two issues remain – the overall size of the replenishment and the proportion of assistance to be provided as grants. The AfDF is expected to adopt a grants program which is similar to the agreement on grants reached in IDA, with an emphasis on grants for urgent human needs such as education, health, and water and sanitation, linked to country performance and commitment to economic reforms. Discussions to date project a replenishment size of \$2.9-3.2 billion to fund AfDF operations over the next 3 years. The Administration is requesting authorization to contribute \$354 million over the next three years. This represents an 18 percent increase in funding over AfDF-8.

The AfDF has been using its comparative advantage as a regional MDB to participate actively in the on-going elaboration of the New Partnership for African Development (NEPAD) initiated by African Heads of State. The NEPAD framework contains a peer review mechanism to assess individual country performance. However, since the specific modalities of a performance-based

or competitive ranking system do not yet exist, they could not inform the AfDF replenishment negotiations.

Asian Development Fund

Important achievements were made during the last replenishment negotiations on the Asian Development Fund (AsDF), including a performance-based system for allocating resources and a Memorandum of Understanding with the World Bank to strengthen collaboration and minimize duplication.

The AsDB, including the AsDF, has moved quickly to assist Afghanistan, by participating in the multi-donor trust fund and by pledging support to finance the country's urgent reconstruction needs. AsDB has approved \$15 million in grants to support critical capacity-building in key ministries, such as health, education, and agriculture, and to assist with disaster preparedness.

The Bush Administration intends to implement its MDB reform agenda for the AsDF, much as it has with IDA including the use of grants. Our ability to influence the policy direction of the institution will be helped over time by a reduction in our arrears.

Global Environment Facility

Negotiations for the third replenishment of the Global Environment Facility (GEF) are currently scheduled to conclude in Washington next month. As contained in the President's Budget for FY2003, the United States is prepared to pledge \$430 million over four years for the replenishment, or \$107.5 million per year, which is equal to our GEF-2 commitment. The FY03 budget request includes the first installment of this pledge. In addition, the Administration proposed a three-year plan to clear \$210.9 million in U.S. arrears to GEF, and requested \$70.3 million for the first payment in FY03. The U.S. is the largest contributor to the GEF, but also the only donor with substantial arrears to the institution, and it is very important to meet our commitments in order to continue to exercise effective leadership and pursue our interests.

The GEF is an effective institution that fills an important niche. An independent review concluded that the GEF has produced significant positive impacts and has laid the foundation for even more substantial results in the future. The Administration is trying to improve the effectiveness of GEF assistance, including agreement to establish a transparent performance-based allocation system that emphasizes country policies and institutional structures essential to effective assistance. Currently, such an allocation system does not exist. Consensus has also been reached on the use of measurable results over the replenishment period. There is also a consensus in the negotiations on the need to develop a private sector strategy, create an independent monitoring and evaluation unit, and open competition for GEF projects by providing implementing agencies with direct access to GEF funding. Finally, agreement was reached to fully segregate Kyoto Protocol funds from the regular GEF programs funded by U.S. contributions.

These reforms, if fully implemented, will sharply improve the impact of GEF projects, thereby providing donors with greater confidence that GEF funds are being used effectively.

North American Development Bank

In March, President Bush and President Fox agreed to reforms to improve the ability of the North American Development Bank (NADBank), and its sister institution, the Border Environment Cooperation Facility (BECC), to address the environmental infrastructure needs of U.S. and Mexican communities along the shared border. These reforms were developed through a broad consultation process and include measures to allow NADBank to increase its low interest rate lending and grant-making activities, to expand the geographic scope for BECC-NADBank operations in Mexico, and to replace the separate BECC and NADBank Boards of Directors with a single board, including federal and non-federal representation. Both presidents also agreed that a comprehensive “business process review” should be conducted to identify ways to improve the overall project design, certification, and implementation process.

These reforms will improve the performance of both institutions in several ways. The financial reforms will make NADBank financing more affordable and thus promote an increase in the Bank’s project financing activities. The geographic expansion will give NADBank opportunities to address a greater scope of important environmental issues that affect communities on both sides of the border. The single Board of Directors should improve coordination and accountability in NADBank and BECC.

Implementation of these reforms is moving forward. Congressional authorization is needed to implement two key reforms – the ability to use NADBank’s paid-in capital for grants and expansion of the institutions’ geographic scope of operations in Mexico. The Administration hopes that the Congress will act on this legislation quickly to enable both governments to implement the agreed reforms and improve the ability of BECC and NADBank to address the serious environmental needs of the people of the border region.

Conclusion

MDB reform has been a priority of the Administration from the outset. I believe that steady progress is being made in achieving our key objectives within each of the institutions and that these reauthorizations will allow us to make further progress. Working with the international affairs staff at Treasury, I will endeavor to be demanding and to set high standards for the MDBs in order to make them more effective in raising living standards around the world.